This is why you’re making losses in options trading

And three ways to avoid them

Options trading can be a profitable way to invest in the stock market, but it can involve a high degree of risk. When starting out, you see losses in options and start getting demotivated.

Does that mean you should avoid options altogether? Certainly not! What you should focus on is *minimising your risk* and *optimising your profit*.

One common mistake that traders make when they start trading in options is to only buy calls and puts. In theory, it sounds utopian — you limit your losses to the premium you pay, and profits are unlimited! But try this strategy for merely a month or two and you’ll see why it’s too good to be true.

An option buyer empties his wallet, an options seller his vault.

Next step that people take is to start selling options only — playing the volume game. But there is a common saying in the market — an option buyer empties his wallet, an options seller his vault.

So if you’re setting yourself up for failure whether you buy or sell, what is the solution?

1. Choosing options with long expiries

Options with longer expiration dates are generally less sensitive to short-term price movements, and therefore offer a lower degree of risk. This means that traders can use options with longer expiration dates to hedge against potential losses and reduce the risk of large losses.

2. Combine with other investments

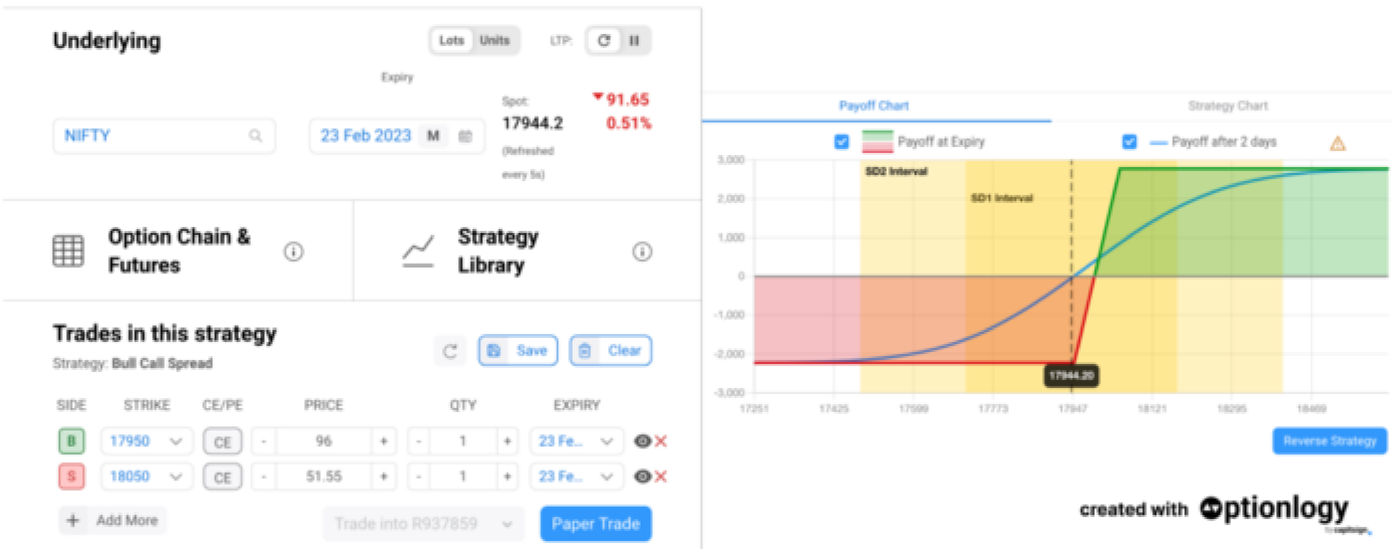
Another strategy to reduce the risk of large losses is the use of options in combination with other investments. For example, a covered call involves owning the underlying asset and selling a call option on the asset.

Let’s say you buy a stock for ₹500 and believe that there might be only a minor movement in this stock in the short term. By selling a call for this stock, you generate income equal to the premium. If the stock price rises at expiry, then you are still covered as you purchased the stock at a lower price originally. If the price doesn’t rise to the strike price, you still earn the premium.

3. **Options Strategies**

Options strategies involve multiple legs or trades in an underlying asset that hedge your losses and protect you from unexpected market movement. Take the *bull call spread* for example.

This is a common options strategy chosen in stock with low volatility, which involves buying a call with a lower strike price and selling a call at a higher strike price. Let's say you buy a Nifty call at ₹17950 and sell it at ₹18050.



Bull call spead showing strategy payoff via optionlogy.com

Now one of 3 scenarios can happen:

1. *Nifty is below ₹17950 at expiry.* In this case, you lose out the premium paid for the long call, but your loss is offset by the premium you earned when you shorted the call at ₹18050.
2. *Nifty is between ₹17950 and ₹18050 at expiry.* Here, your short call earns you the profit equal to your premium, and your long call makes you profits as well.

3. *Nifty is above ₹18050 at expiry.* Yes, you lost that premium with the long call, but you also profit from the call that you had sold!

Doesn’t that sound like a much more comfortable position than simply buying or selling a Nifty option?!

That’s how options strategies insulate you from adverse condition in the market and help you get a good night’s sleep on the mattress of money you just earned!

If you want to learn more about options strategies, you can log onto optionlogy.com and play around with the different strategies in their strategy builder. Why?

→ Largest library of pre-made strategies trusted by traders and analysts

→ Instant payoff calculator and chart

→ It’s completely free for the first 30 days

In conclusion

Buying or selling options alone can result in significant losses in options trading, especially if the price of the underlying asset moves in an unexpected direction or if the options are affected by volatility.

It is important to understand the risks associated with options trading and to have a clear investment objective before entering any options strategy. Traders should also be aware of the impact of volatility and other factors on options prices, and should consult with a financial advisor before making any investment decisions.